



Utilities

Utilities/Power: Investor sentiment

Summary:

We summarized key investor arguments for electric/gas utility and power stocks with the most positive (AES, ES, ETR, EXC, FE, NEE, NRG), most negative (AGR, ATO, SRE, WTRG) and the tug-of-war sentiment (DTE, DUK, EIX, PPL, SO and VST) ahead of the 3Q20 earnings season and the annual EEI financial conference.

Highlights

Names with most positive investors' sentiment (in alphabetical order):

AES (AES, Buy, PT \$21):

- Green wave - more renewable power/storage PPAs + incremental coal plant retirements/divestitures;
- Growth in regulated utility capex/earnings in IN/OH;
- IG rating from S&P as soon as early November.

Entergy (ETR, Buy, PT \$113):

- Visible/above-average rate base growth;
- Improving capex execution and regulatory relationships;
- Truly discounted valuation and low customer bills even after securitization of growing storm costs.

Eversource (ES, Buy, PT \$99):

- 3Q20 miss + likely delay of the South Fork offshore wind project + likely regulatory fine in CT following storm Isaias.
- Yet, annual EPS growth should rise to 7% for 2021-2023 thanks to Columbia Gas.
- ~10% annual EPS growth in 2024/2025 thanks to offshore wind.

Exelon (EXC, Buy, PT \$45):

- Spin-off of ExGen/Constellation seems unlikely any time soon.
- Yet, Biden's wind/Blue sweep could lead to carbon pricing which would be highly beneficial for merchant nuclear plants;
- Current valuation doesn't reflect much value for ExGen.

FirstEnergy (FE, Buy, PT \$42):

- Update on the DOJ investigation of lobbying practices surrounding the HB 6 in OH - a potential settlement without admission of any wrongdoing? The first update from CEO since 2Q20 call.
- Continued strong operational performance;
- Current valuation reflects unraveling of regulatory setup in OH (ESP settlement and changes to overearning/SEED test) which are seen as increasingly unlikely;
- A likely M&A target once the DOJ risk is addressed.

NextEra Energy (NEE, Buy, PT \$324):

- Accelerating renewable power spending seems largely independent of November election results;
- Marginal investor in US utilities has an ESG mandate so NEE should continue to outperform XLU;
- Biden's win/Blue sweep would be additive to growth of NEER;
- NEE needs to watch its earnings mix for credit reasons - a large regulated utility acquisition could grow in importance after the Democratic sweep.

NRG Energy (NRG, Buy, PT \$48):

- Proposed sale of PJM plants and incremental cost efficiencies at NRG could eliminate \$750MM in converts to finance Direct Energy;
- PJM coal plant divestitures should boost NRG's ESG profile;
- 20%+ 2022 FCF yield with fewer questions about the longevity of cash flows.

Names with most negative investors' sentiment (in alphabetical order):

Atmos Energy (ATO, Buy, PT \$108):

- Marginal equity investor for US utilities is an ESG investor, and he's not interested in gas LDCs, even those in gas supportive states (like TX or PA);
- ATO's P/E premium is measured vs. P/Es of other gas LDCs and not all electric/gas utilities; as other gas LDCs derate so does ATO.

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- ATO's upcoming addition to the DJUA could boost the stock.

Avangrid (AGR, Neutral, PT N/A):

- Stock sharply re-rated thanks to renewable power halo effect even though AGR's Renewables business struggles;
- Analyst day (Nov 5) should (yet again) re-set earnings expectations:
 - Whisper buy-side expectations for 2022 EPS of \$2.45 are already meaningfully below sell-side consensus expectations, however, though the \$1.95 midpoint of the new 2020 EPS guidance was lower than the \$2.10 whisper number.
- Potential combination with PPL/WPD could still be possible, and could be decided by Iberdrola, AGR's majority owner, in December/January.

Essential Utilities (WTRG, Neutral, PT N/A):

- Peoples Gas should increasingly suppress WTRG's P/E multiple as ESG investors stay away from gas LDCs;
- WTRG may need to spin off the gas LDC to rebuild its water P/E, or be taken over by an electric/gas utility.

Sempra Energy (SRE, Buy, PT \$144):

- Expansion of Cameron or construction of ECA/Port Arthur LNG facilities now very unlikely;
- Monetization of a portion of Cameron LNG terminal should be difficult following lengthy storm-related outages (no backup power);
- Lack of extension of franchise agreement with San Diego would be a major negative leaving SRE with a gas LDC in CA, with limited long-term growth prospects;
- Share buyback is not being executed, and it's announcement on the 2Q20 earnings call is seen by many as an attempt to boost the stock price ahead of a potential regulated utility acquisition in TX. Yet, the company could still reiterate their willingness to support the stock with buybacks.

Tug of war names (in alphabetical order):**DTE Energy (DTE, Buy, PT \$133.50):**

- Management seems focused on correcting its stock's valuation discount.
- Yet, a spin-off of midstream assets might not create much (if any) shareholder value: a mid-cap midstream stock (~\$3-3.5B in market cap) with a major technical overhang (as utility investors will want out) should not trade well.
- Instead, DTE could try to dilutive its midstream exposure through an acquisition of a regulated utility, preferably an electric utility with a contiguous service territory. CMS seems like an unlikely seller so it would have to be outside of MI.

Duke Energy (DUK, Neutral, PT N/A):

- NEE-DUK combination could create very meaningful shareholder value for both companies, and many LO investors continue to expect the combination to eventually happen; A lot depends on the outcome of the November elections.
- A blue sweep in D.C. could make the combination even more likely as NEE should need to address its earnings mix with a likely re-acceleration of its renewable power growth.
- A blue sweep in NC could boost DUK's standalone value and its appeal to NEE.
- The regulatory approval of the combination should be challenging. Investors believe the transaction is being blocked by DUK's Board/management only partly due to regulatory concerns.

Edison International (EIX, Buy, PT \$62) and PG&E (PCG, Neutral, PT N/A):

- Recent rebound in stocks of EIX/PCG is seen as driven by a value trade rather than any fundamental reasons,
- Yet, we are getting close to the beginning of a seasonal trade in CA electric utilities.
- The Victims Trust doesn't seem to be shedding PCG's stock. And EIX could be announcing additional settlements of 2017/2018 wildfires.
- Yet, both stocks need to issue equity as soon as December/January.

PPL (PPL, Neutral, PT N/A):

- The sale of WPD is still months away and 2020 results from the business should disappoint due to COVID.
- Recent CMA rulings on ROEs/capex of UK water utilities are seen as positive for WPD's future earnings power and thus its sale price.
- Yet, WPD's sale would create meaningful shareholder value only if it's sold at north of 1.45x 2021 EV/RAB and PPL manages to eliminate practically all tax leakage.
- It's still possible, especially if Iberdrola were to agree to a swap between WPD and a majority stake in AGR. Yet, it remains unclear if Iberdrola is open to it, and the outcome of the US elections could determine the value of AGR.

Southern Company (SO, Buy, PT \$66):

- Cold hydro testing is done and hot functional testing could start as soon as mid/late-November.
- Yet, the duration of the HFT is unknown and no one knows what SO's Georgia Power should uncover once the reactor (Vogtle Unit 3) is pressurized and the steam generator is turned on.

Vistra Energy (VST, Buy, PT \$24):

- The stock looks cheap on practically every metric and buybacks should start in early 2021.
- Yet, VST's merchant renewable power/storage investments in TX conflict with VST's bullish views on fwd power prices in the state.
- Investors would prefer more buybacks or an investment in a renewable power developer (like AES's acquisition of sPower). Otherwise, terminal value questions should continue to weigh on the stock.

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Other Companies Mentioned in This Report

- AES Corporation (AES: \$20.00, Buy)
- Atmos Energy Corp. (ATO: \$94.28, Buy)
- Duke Energy Corp. (DUK: \$92.06, Neutral)
- Eversource Energy (ES: \$92.24, Buy)
- FirstEnergy Corp. (FE: \$31.83, Buy)
- NRG Energy, Inc. (NRG: \$33.18, Buy)
- PPL Corporation (PPL: \$28.07, Neutral)
- Sempra Energy (SRE: \$129.68, Buy)
- Essential Utilities, Inc. (WTRG: \$42.10, Neutral)
- Avangrid, Inc. (AGR: \$54.06, Neutral)
- DTE Energy Company (DTE: \$121.34, Buy)
- Edison International (EIX: \$59.75, Buy)
- Exelon Corporation (EXC: \$42.40, Buy)
- NextEra Energy, Inc. (NEE: \$300.99, Buy)
- PG&E Corporation (PCG: \$10.92, Neutral)
- Southern Co. (SO: \$58.60, Buy)
- Vistra Energy Corp. (VST: \$18.95, Buy)
- Entergy Corporation (ETR: \$106.22, Buy)

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